

Fiscal Note

State of Alaska
2015 Legislative Session

Bill Version: HB 182
Fiscal Note Number: _____
() Publish Date: _____

Identifier: HB182-DOR-TAX-4-15-15
Title: INDIVIDUAL INCOME TAX AND TAX CREDITS
Sponsor: SEATON
Requester: House Finance Committee

Department: Department of Revenue
Appropriation: Taxation and Treasury
Allocation: Tax Division
OMB Component Number: 2476

Expenditures/Revenues

Note: Amounts do not include inflation unless otherwise noted below. (Thousands of Dollars)

	FY2016	Included in	Out-Year Cost Estimates				
	Appropriation Requested	Governor's FY2016 Request	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
OPERATING EXPENDITURES	FY 2016	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
Personal Services	1,250.0		3,400.0	6,000.0	6,300.0	6,600.0	6,900.0
Travel	50.0		100.0	100.0	100.0	100.0	100.0
Services	200.0		700.0	1,000.0	1,100.0	1,200.0	1,300.0
Commodities	50.0		100.0	100.0	100.0	100.0	100.0
Capital Outlay							
Grants & Benefits							
Miscellaneous							
Total Operating	1,550.0	0.0	4,300.0	7,200.0	7,600.0	8,000.0	8,400.0

Fund Source (Operating Only)

1005 GF/Prgm	1,550.0		4,300.0	7,200.0	7,600.0	8,000.0	8,400.0
Total	1,550.0	0.0	4,300.0	7,200.0	7,600.0	8,000.0	8,400.0

Positions

Full-time	10.0		24.0	44.0	44.0	44.0	44.0
Part-time			16.0	16.0	16.0	16.0	16.0
Temporary							

Change in Revenues	285,000.0		655,000.0	680,000.0	695,000.0	710,000.0	725,000.0
---------------------------	-----------	--	-----------	-----------	-----------	-----------	-----------

Estimated SUPPLEMENTAL (FY2015) cost: 250.0 *(separate supplemental appropriation required)*
(discuss reasons and fund source(s) in analysis section)

Estimated CAPITAL (FY2016) cost: 14,000.0 *(separate capital appropriation required)*
(discuss reasons and fund source(s) in analysis section)

ASSOCIATED REGULATIONS

Does the bill direct, or will the bill result in, regulation changes adopted by your agency? **yes**
If yes, by what date are the regulations to be adopted, amended or repealed? **01/01/16**

Why this fiscal note differs from previous version:

Initial Version

Prepared By: <u>Ken Alper, Director</u>	Phone: <u>(907)465-8221</u>
Division: <u>Tax Division</u>	Date: <u>04/15/2015 11:00 AM</u>
Approved By: <u>Jerry Burnett, Deputy Commissioner</u>	Date: <u>04/15/15</u>
Agency: <u>Department of Revenue</u>	

FISCAL NOTE ANALYSIS

STATE OF ALASKA
2015 LEGISLATIVE SESSION

BILL NO. HB 182

Analysis

Bill Analysis

The bill establishes a personal income tax based on 15% of the taxpayer's federal tax liability. In addition, there is an additional tax that will be, in most cases, 10% of the taxpayer's long term capital gains. The tax is payable by both Alaska residents and non-residents on the portion of their income derived from income earned within the State. Like the federal income tax, it would be payable based on calendar year earnings.

To qualify as "from a source in the state," income is broadly defined to include regular compensation, as well as income and rents from property, business, and other assets within Alaska. Business income, including partnership income and earnings from subchapter-S corporations transacting business in Alaska will also be subject to this tax.

The bill provides for withholding of income by employers, with regular remittance to the state. Employers must also provide annual income statements analogous to the federal W-2. The annual tax return would be due at the same time as the federal return, currently April 15 with any extensions tied to the federal filing. Both payments and refund requests would be received with the annual filing.

In its first year of full implementation, the cost to the average Alaskan would be about \$900 per capita. As the impact would be proportionate to each household's federal tax, it would vary widely by income level and eligibility for various federal tax credits. Any impact would be partially mitigated because state individual income taxes are deductible from federal taxes, meaning Alaskans who itemize would reduce their federal tax liability by the amount of their state tax multiplied by their marginal federal tax rate.

Revenue Impact

The Tax Division has created an income tax revenue model based on aggregated federal income data for Alaska residents. We then account for incremental revenue based on the estimated income of out of state residents, partially offset by the out-of-state income of Alaskans.

The model assumes moderate underlying growth and inflation in the state economy, thus generating increasing nominal revenues from year to year. It also includes a coefficient that reduces the growth rate proportionally as the tax rate increases. A high enough tax rate would effectively begin shrinking the state's economy.

The bill would take effect on January 1, 2016, meaning that FY16 revenue would be for only the second half of the fiscal year, entirely in the form of withholding taxes. For FY17, the first full year, the revenue is estimated as follows: 15% tax at \$580 million (including estimated revenue from out of state residents) plus 10% capital gains tax at \$85 million for a total of \$665 million.

Implementation Cost

Adding an individual income tax, especially on a tight timeline, would be a significant challenge to the Tax Division. We are currently in the third and final phase of implementing the Tax Revenue Management System (TRMS), which is creating an integrated online tax application used by both taxpayers and administrators for the 24 tax types currently administered by the Division. We expect to engage FAST Enterprises, the TRMS contractor, to build an income tax module into TRMS. The timing works well with the expected wind-down of the TRMS project; FAST already has staff mobilized in Alaska who are well informed about our processes and have excellent working relations with our staff. FAST has built and currently maintains individual income tax systems for 17 other states, and is currently developing them in at least four others.

The initial need will be to engage a contractor to work with Department leadership to create an implementation plan with more refined estimates of staffing, space, supply, and equipment needs. The cost estimates in this fiscal note are a first attempt to anticipate the results of this analysis. The \$250.0 supplemental request will enable us to develop this plan.

FISCAL NOTE ANALYSIS

**STATE OF ALASKA
2015 LEGISLATIVE SESSION**

BILL NO. HB 182

Analysis Continued

The \$14,000.0 capital request reflects an estimate for our contract with FAST to add the income tax module as well as the Department's other short term implementation costs. This is a multi-year process and much of the actual spending will not occur until after we begin collecting revenues. The initial fast-track need will be to build and implement a tax withholding system, which will need to be in operation by January 1, 2016. In addition to the software development, this will require a rapid and robust outreach to the business community throughout Alaska, as well as integration with national accounting and tax software vendors in order to update programs such as TurboTax and QuickBooks to incorporate Alaska.

Once the withholding system is in place, the contractor and staff will begin building the tax return filing and examination modules, with their associated databases, communications, and integration with our existing imaging, accounting, and collections systems. The legislation creates an annual tax, meaning that the first tax returns will be filed in January of 2017, with a filing due date of April 15. Taxpayers who request and receive extensions would have filing deadlines in October of 2017.

The department envisions a gradual ramping up of the staff needed to collect and administer the tax. As part of our research into the potential costs, we spoke to tax administrators at the State of Montana, which has a population about 1/3 higher than Alaska's and uses FAST for its income tax. Montana's Revenue Department has 155 employees dedicated to their income tax, which scales back to about 120 for Alaska using a simple per-capital adjustment. We intend to implement an income tax with half this number, 60 employees including a substantial group of seasonal part-time imaging and data entry technicians. We expect the new staff to be roughly split between our Juneau and Anchorage offices.

We expect to replicate the online filing percentages of the Permanent Fund Division, currently at 83%. However, the 17% of paper filers will entail manual handling and data entry for approximately 75,000 out of 400,000 tax returns. In contrast, the Tax Division's largest current taxpayer base is the State Corporate Income Tax, with approximately 22,000 total filers half of whom file perfunctory reports indicating no tax liability due to their S-corporation status.

We do not expect to need full staffing until FY18. The eventual addition of 52 FTE's to the Tax division (44 full time plus 16 part time imaging and data entry technicians) would increase the staff of the Tax Division by approximately 45%. However, throughout the six-year period covered by this fiscal note, we anticipate total implementation costs, operating plus capital, to equal approximately 1% of additional state revenue.

An initial analysis of the staff needs within the Tax Division to implement a personal income tax is as follows

Title	FY16	FY17	FY18+
Audit Supervisor	2	2	2
Tax Auditor	4	9	18
Tax Technician	2	6	10
Income Tax Specialist	1	2	2
Appeals Officer	0	1	5
Accounting Technician	0	2	4
Admin Assistant	1	2	3
Total FT	10	24	44
Imaging Operators & Office Assistants	0	16	16
Total PT	0	16	16